HIGHTOWER
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Market Commentary Q4 2024

For investors, 2024 was a year of surprises, defying many of the predictions that economists and strategists made at this time last year. At a high level, it was a good year for risk assets. Equities climbed as prospects for Federal Reserve ("Fed") rate cuts and soft landing came into view while the artificial intelligence ("AI") revolution continued to unfold. Investor optimism got a further boost from post-election animal spirits. The year did end on a more cautious note as stocks dropped in December as investors took profits and uncertainty mounted. The market's mood soured after Fed officials signaled they're penciling in just two rate cuts this year, the U.S. 10-year yield hit 4.5% and U.S. dollar climbed to a fresh record.[1]

The S&P 500 ended the year up about 25%, matching 2023's gain.[1] It's only the fourth time in the past century that the index has notched 20%+ returns for two years straight.[1] The technology heavy Nasdaq surged nearly 30%, fueled by AI hype, Fed rate cuts, and a perception that POTUS-elect Trump's policies will be favorable for markets. Crypto had a great run, too, with bitcoin more than doubling on the year.[1]

Leading US Indices (Total Return)	2Q'23	3Q'23	4Q'23	1Q'24	2Q'24	3Q'24	4Q'24 (sorted)	TTM
Nasdaq	13.1%	-3.9%	13.8%	9.3%	8.5%	2.8%	6.3%	29.6%
S&P/Citigroup Growth	10.6%	-2.6%	10.1%	12.8%	9.6%	3.7%	6.2%	36.1%
S&P 100 Mega-Cap	11.1%	-2.8%	11.7%	11.2%	7.1%	5.1%	4.6%	30.9%
S&P 500 Total Return	**8.7%**	**-3.3%**	**11.7%**	**10.6%**	**4.3%**	**5.9%**	**2.4%**	**25.0%**
S&P 400 Mid-Cap	4.9%	-4.2%	11.7%	10.0%	-3.4%	6.9%	0.3%	13.9%
Russell 2000	5.2%	-5.1%	14.0%	5.2%	-3.3%	9.3%	0.3%	11.5%
S&P 600 Small-Cap	3.4%	-4.9%	15.1%	2.5%	-3.1%	10.1%	-0.6%	8.7%
S&P/Citigroup Value	6.6%	-4.1%	13.6%	8.1%	-2.1%	9.1%	-2.7%	12.3%

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The last time we saw such market strength was in the late 1990s, as the emergence of the internet set off a technology stock boom, that, on the surface, looks a bit like what we're seeing today. In the 1990s, the stock market grew increasingly concentrated as investor excitement around emerging technology giants increased their market valuations tremendously, giving them larger and larger weights in market-cap-based indexes like the S&P 500 (sound familiar?!). Of course, that boom ended badly, as astronomical valuations for some of those companies came back to earth and the S&P 500 fell 50% from its 2000 peak to its bottom in October 2002.[1]

Today, we have a somewhat similar scenario, with AI-related investor excitement creating new technology titans. And there's certainly more than a bit of euphoric sentiment at play, as key valuation metrics show. The difference is that the giants of today's stock market are nowhere near as overvalued as they were in the 1990s. Market bulls argue that the massive profits companies are producing insulate the market from the kind of collapse we saw then. Maybe, but a few of those companies at their ’90s peak had price-to-earnings multiples not dissimilar to what we are witnessing today, and that didn’t stop many stocks from halving during the dotcom bust!

S&P 500 Sectors (Total Return)	2Q'23	3Q'23	4Q'23	1Q'24	2Q'24	3Q'24	4Q'24 (sorted)	TTM
Discretionary	14.6%	-4.8%	12.4%	5.0%	0.6%	7.8%	14.3%	30.1%
Communication Services	13.1%	3.1%	11.0%	15.8%	9.4%	1.7%	8.9%	40.2%
Financials	5.3%	-1.1%	14.0%	12.5%	-2.0%	10.7%	7.1%	30.6%
Technology	17.2%	-5.6%	17.2%	12.7%	13.8%	1.6%	4.8%	36.6%
S&P 500 Total Return	**8.7%**	**-3.3%**	**11.7%**	**10.6%**	**4.3%**	**5.9%**	**2.4%**	**25.0%**
Industrials	6.5%	-5.2%	13.1%	11.0%	-2.9%	11.5%	-2.3%	17.5%
Energy	-0.9%	12.2%	-6.9%	13.7%	-2.4%	-2.3%	-2.4%	5.7%
Staples	0.5%	-6.0%	5.5%	7.5%	1.4%	9.0%	-3.3%	14.9%
Utilities	-2.5%	-9.2%	8.6%	4.6%	4.7%	19.4%	-5.5%	23.4%
Real Estate	1.8%	-8.9%	18.8%	-0.5%	-1.9%	17.2%	-7.9%	5.2%
Health Care	3.0%	-2.7%	6.4%	8.8%	-1.0%	6.1%	-10.3%	2.6%
Materials	3.3%	-4.8%	9.7%	8.9%	-4.5%	9.7%	-12.4%	0.0%

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At first glance, it seems difficult to fathom these types of returns with the headlines that were facing the markets in 2024! While today feels different, when we look at things through an objective long-term lens, we realize times like these occur more often than one would think. As you’ll see below, all-time highs happen a lot and have done so a great deal recently:

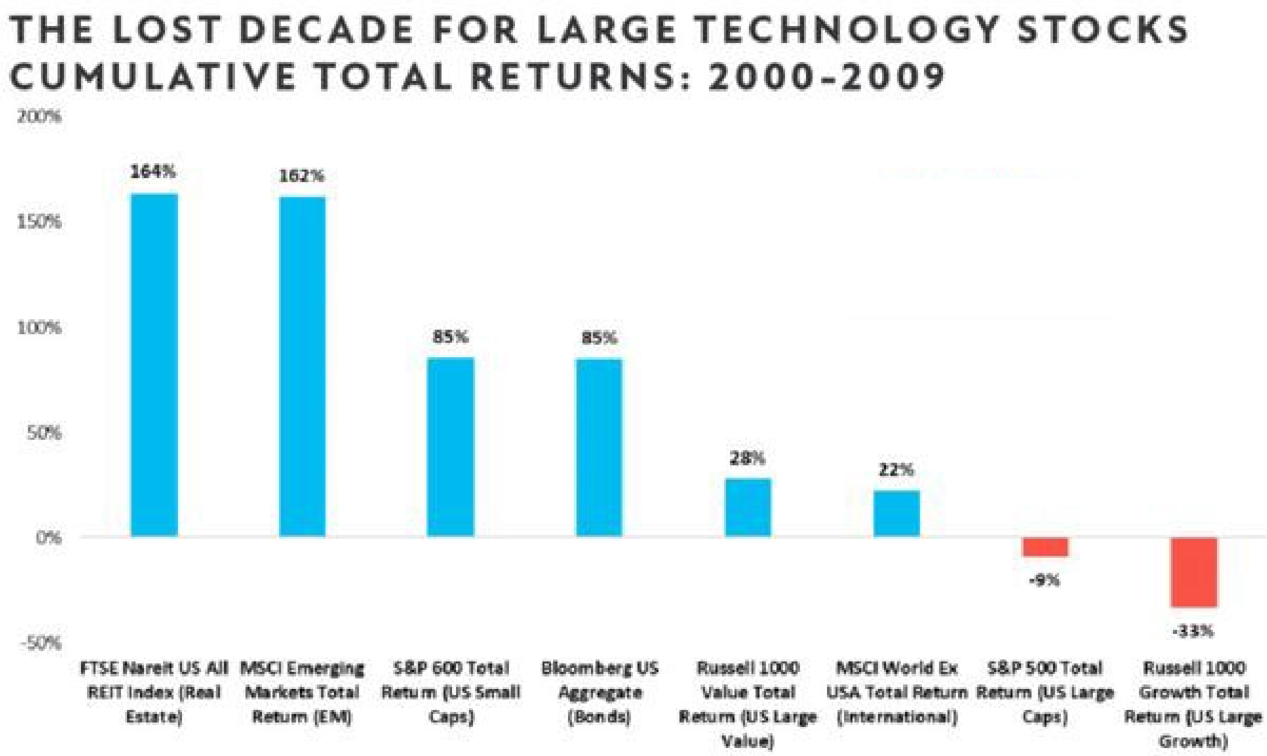
S&P 500 Index: Number of All-Time Highs (1929 - 2024)

Year	# ATH	Year	# ATH	Year	# ATH	Year	# ATH	Year	# ATH
1929	45	1949	0	1969	0	1989	13	2009	0
1930	0	1950	0	1970	0	1990	6	2010	0
1931	0	1951	0	1971	0	1991	22	2011	0
1932	0	1952	0	1972	32	1992	18	2012	0
1933	0	1953	0	1973	3	1993	16	2013	45
1934	0	1954	27	1974	0	1994	5	2014	53
1935	0	1955	49	1975	0	1995	77	2015	10
1936	0	1956	14	1976	0	1996	39	2016	18
1937	0	1957	0	1977	0	1997	45	2017	62
1938	0	1958	24	1978	0	1998	47	2018	19
1939	0	1959	27	1979	0	1999	35	2019	36
1940	0	1960	0	1980	24	2000	4	2020	33
1941	0	1961	53	1981	0	2001	0	2021	70
1942	0	1962	0	1982	2	2002	0	2022	1
1943	0	1963	12	1983	30	2003	0	2023	0
1944	0	1964	65	1984	0	2004	0	**2024**	**57**
1945	0	1965	37	1985	43	2005	0		
1946	0	1966	9	1986	31	2006	0		
1947	0	1967	14	1987	47	2007	9		
1948	0	1968	34	1988	0	2008	0		

Y-Charts – 01/03/2025

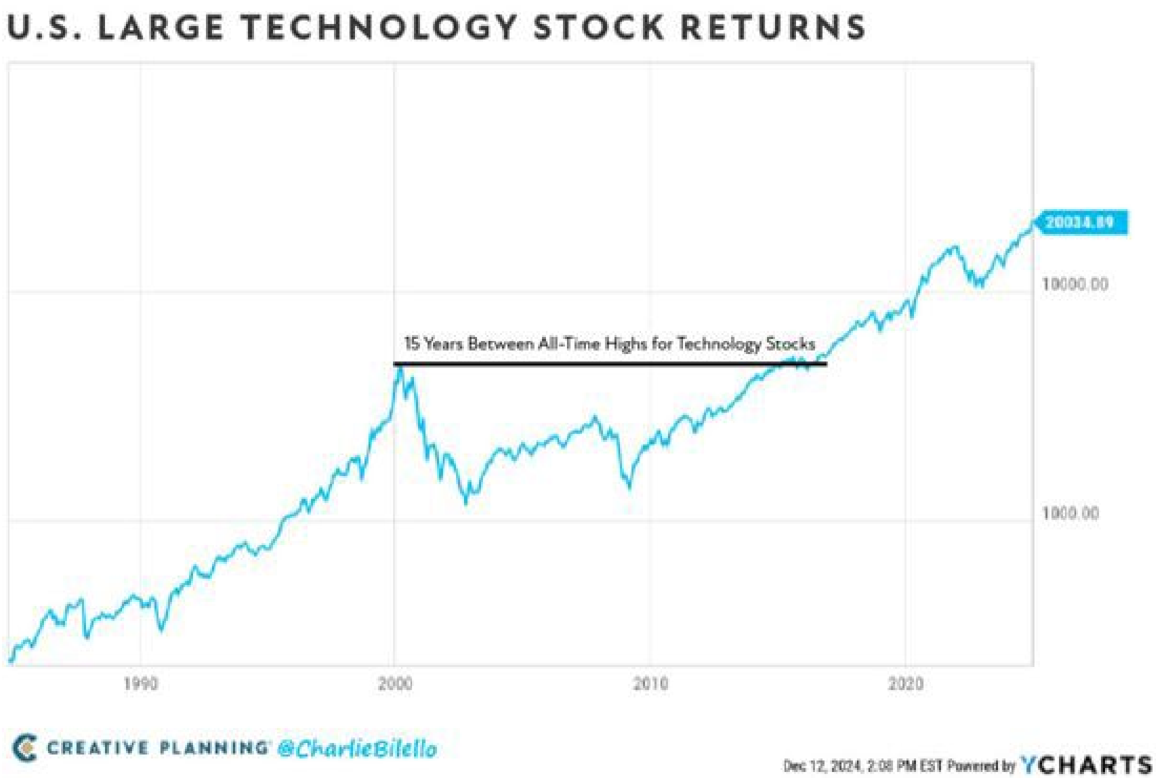
What also happens often, although not nearly as frequently, are long bouts of no new all-time highs. This is difficult to comprehend, especially when the strongest gains are bunched into only a handful of asset classes, like now with large domestic technology stocks.

If we look after the dotcom bubble, and for almost a decade, the Russell 1000 Growth Index (a proxy of large cap technology stocks) lost a whopping 33% of their value while other sectors and styles performed much better. Avoiding these prolonged periods of market stagnation mandates putting more of your eggs in different baskets, in other words, diversification. Each basket has its own moment in the sun, but this is the key to sustained portfolio performance.



Y-Charts – 01/03/2025

To further the point, it took large technology stocks approximately 15 years to return to all-time highs, as graphed below:



Y-Charts – 01/03/2025

A reversion to the mean may be coming soon, or the party may go on for much longer. We don't know, and frankly, no one else does either. However, using history as our guide, this bull market has been historically short in both duration and overall returns thus far.

GDP growth averaged 2.6% quarter on quarter annualized over the first three quarters of 2024 and the Federal Reserve Bank of Atlanta GDP is projecting a similarly strong end to the year.[1] Despite the Fed implementing one of the most aggressive rate-hiking cycles in the last half century, the U.S. economy was resilient. This economic strength persisted even as sectors like commercial real estate, regional banks, and many smaller companies and startups faced big challenges. While supportive fiscal policy has likely helped, a few factors may also explain the economy's resilience. The less-regulated "shadow banking" system, including private equity firms, may have helped to buffer the impact of Fed tightening by providing alternative financing sources to businesses. Additionally, wealth has become increasingly concentrated among large corporations and affluent households, which typically hold excess cash and may be less sensitive to interest rate changes. As a result, they were likely able to bolster the economy with continued spending.

Rising unemployment didn't materially hurt consumption either. Historically, a meaningful rise in the jobless rate often signals a downturn in consumer spending and economic activity. However, even as unemployment increased from 3.7% to 4.2% last year, overall consumer spending remained strong.

Strong risk asset performance carried over into the bond market as well. High-yield bonds were the top-performing sector for the fourth year in a row, as a combination of high all-in yields and tightening spreads boosted returns. Longer-duration investment-grade credit underperformed against backdrop of rising government bond yields.

US Yields	3Q'23	4Q'23	1Q'24	2Q'24	3Q'24	4Q'24	Q/Q Chg (bps)	Y/Y Chg (bps)
Fed Funds Target Rate	5.5	5.5	5.5	5.5	5.0	4.5	-50	-100
3-Month T-Bill	5.6	5.4	5.5	5.5	4.7	4.4	-36	-103
2-Year Note	5.0	4.3	4.6	4.7	3.6	4.2	60	-1
5-Year Note	4.6	3.8	4.2	4.3	3.6	4.4	82	54
10-Year Bond	4.6	3.9	4.2	4.4	3.8	4.6	79	69
30-Year Bond	4.7	4.0	4.3	4.5	4.1	4.8	67	75
Fed Funds Target Rate	5.5	5.5	5.5	5.5	5.0	4.5	-50	-100

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The bond market experienced considerable volatility in the last quarter of 2024, primarily driven by geopolitical tensions, central bank decisions, and fluctuating inflation rates. The Bloomberg Barclays U.S. AGG Index finished the year with a positive return of 1.18%, although the popular bond index is still negative over a three-year period, with an annualized return of -2.59% over the past three years.[1]

U.S. Treasury Bonds sold off in October amid concerns over potential inflationary policies arising from a possible Republican victory in the presidential election. Inflation figures saw an unexpected uptick, leading to a rise in bond yields as market priced in fewer rate cuts for 2025. By the end of December, the Fed had cut rates for the third consecutive time, bringing the target range to 4.25%–4.5%, but Fed Chair Jerome Powell indicated fewer cuts might follow due to persistent inflation concerns.

The 10-year Treasury yield experienced a notable rise, finishing the year at 4.57%, indicating market uncertainty regarding the Fed's future actions amidst rising expectations for inflation.

Convertible bonds staged a comeback in the final quarter of 2024. Amid declines for global equities, the FTSE Global Focus convertible bond index gained 2.1% for the quarter.[1] Meanwhile, municipal bonds posted solid returns, with the S&P National AMT-Free Municipal Bond Index finishing the year with its strongest quarterly gain since 2009. Municipal bond new issue supply remained muted, but demand strengthened following expected further Fed rate cuts. Overall, municipal bonds have shown resilience and strong performance in a challenging economic environment. They remain an attractive option for investors looking for defensive characteristics and lower default rates compared to other fixed income products.

Looking abroad, European economic momentum weakened significantly over the year as the U.S. dollar continued to strengthen. (This is a great time to make international travel plans to stretch your dollar further.). The manufacturing sector was hit particularly hard due to a combination of high energy costs, damaging regulation, and a lack of export demand, coupled with government subsidized competition from China. This divergence was compounded by political turmoil in both France and Germany, where fiscal pressures and the rise of populist parties fractured the political consensus. Economic weakness and limited exposure to AI hindered European equities, and in a year of strong equity returns the region underperformed with returns of 8.1%.[1]

International Indices (Price Chg)	2Q'23	3Q'23	4Q'23	1Q'24	2Q'24	3Q'24	4Q'24 (sorted)	TTM
Nikkei 225 (Japan)	18.4%	-4.0%	5.0%	20.6%	-1.9%	-4.2%	5.2%	19.2%
S&P/TSX (Canada)	0.3%	-3.0%	7.3%	5.8%	-1.3%	9.7%	3.0%	18.0%
DAX (Germany)	0.3%	-4.7%	8.9%	10.0%	-3.9%	6.0%	3.0%	15.4%
Shenzhen SE A Shares (China)	-3.6%	-6.8%	-3.8%	-4.9%	-7.4%	19.1%	1.6%	6.5%
MSCI AC World	6.0%	-2.9%	9.0%	9.0%	2.9%	4.5%	1.0%	18.4%
FTSE 100 (UK)	-1.3%	1.0%	1.6%	2.8%	2.7%	0.9%	-0.8%	5.7%
MSCI EAFE	3.2%	-1.9%	4.6%	9.1%	0.0%	0.3%	-0.9%	8.4%
All Ordinaries (Australia)	0.4%	-2.1%	8.0%	4.1%	-1.7%	6.5%	-1.4%	7.5%
IBEX 35 (Spain)	3.9%	-1.7%	7.1%	9.6%	-1.2%	8.5%	-2.4%	14.8%
CAC 40 (France)	1.1%	-3.6%	5.7%	8.8%	-8.9%	2.1%	-3.3%	-2.2%
Swiss Market Index	1.6%	-2.8%	1.6%	5.3%	2.2%	1.5%	-4.7%	4.2%
Hang Seng (Hong Kong)	-7.3%	-5.9%	-4.3%	-3.0%	7.1%	19.3%	-5.1%	17.7%
OMX Stockholm 30 (Sweden)	3.9%	-6.7%	11.2%	5.1%	2.0%	2.2%	-5.5%	3.6%
Bolsa (Mexico)	-0.7%	-5.0%	12.8%	0.0%	-8.6%	0.1%	-5.6%	-13.7%
Sensex (India)	9.7%	1.7%	9.7%	2.0%	7.3%	6.7%	-7.3%	8.2%
Kospi (South Korea)	3.5%	-3.9%	7.7%	3.4%	1.9%	-7.3%	-7.5%	-9.6%
Bovespa (Brazil)	15.9%	-1.3%	15.1%	-4.5%	-3.3%	6.4%	-8.7%	-10.4%

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In Asia, Chinese activity remained weak as the country grappled with falling and volatile property prices, as well as weak consumer confidence. Initially, investors across the globe were unimpressed with China's policy responses. However, September's more cohesive policy announcements appeared to convince markets that we might finally see the significant stimulus required to restart the economy. As a result, Chinese equities rallied in the second half of the year to deliver an almost 20% return over 2024.[1] Continued optimism about the end of deflation, coupled with a weak yen and ongoing corporate reforms, helped Japanese equities deliver returns of 20.5% to end 2024 as the second best performing major equity market.[1]

Overall, the market showed resilience despite mixed signals last year, and the outlook for 2025 remains cautiously optimistic. As we enter the new year with the ten-year note hovering around 4.6% and the S&P 500 trading at 22x forward earnings, we are in an environment with little or no equity risk premium.[1] Of course, earnings growth and interest rates are not static and ultimately, the markets will adjust to the appropriate price level between rates and market multiples. The Fed is expected to continue measured rate cuts, with the terminal fed funds rate likely reaching around 3.25% to 3.50% by mid-2025.

The chances of a recession in 2025 are relatively low given the strength in corporate profits, strong labor markets, and tight credit spreads. Still, considering the S&P 500 valuation, the VIX trading at 17, and Bitcoin at close to $100,000, it is safe to assume that expectations for risk assets remain high.[1] With the largest 10 stocks in the S&P 500 comprising nearly 40% of the index, a good portion of outperformance for active managers this year will be driven by determining how long the A.I. trade will continue to outperform. There are times, of course, when great companies can be bad stocks.

One lesson to reinforce is to avoid short-term market prognostications. In the short run, it's a pure guess; in the long run, it's math. Whether the bull market continues really shouldn't matter for long-term investors putting their money to work. The data is overwhelmingly supportive of just getting your money working on your behalf. Albert Einstein called compounding interest the eighth wonder of the world for a reason! The future returns of equity markets are very compelling regardless of when dollars go in. On a daily basis, the results are almost immeasurable, but they make all the difference over the long term.

Suffice to say, 2024 was a year that challenged many traditional economic assumptions and models. Given this unpredictability, portfolio risk management should remain a key focus for prudent long-term investors heading into 2025. In particular, consider rebalancing portfolios to strategic asset allocation targets and pursuing maximum diversification among stocks, bonds, real assets, hedge funds, and private investments.

Thank you for your trust in 2024 and we look forward to a great year ahead!

To discuss this commentary further, please contact us at 914-825-8630.

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[1] Y-Charts – 01/03/2025
[2] Strategas Securities, LLC – 01/03/2025

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